
POLICY MATTERS OHIO

CLEVELAND OFFICE: 3631 PERKINS AVENUE, SUITE 4C-EAST • CLEVELAND, OHIO, 44114 • 216/361-9801
COLUMBUS: 1372 GRANDVIEW AVENUE, SUITE 242, COLUMBUS, OH 43212 • 614/486-4601
[HTTP://WWW.POLICYMATTERSOHIO.ORG/](http://www.policymattersohio.org/)

**Testimony of Zach Schiller
on Ohio Tax Reform before the
House Ways & Means Committee
August 22, 2006**

Thank you for the opportunity to present testimony on Ohio tax reform. First, I would like to address some tax reform proposals that have been made in recent months to flatten or further reduce the personal income tax. The income tax is the main tax that evens out the share of income that people of different incomes pay in Ohio state and local taxes. Lower- and middle-income Ohioans pay a larger share of their incomes in all state and local taxes taken together than the most affluent Ohioans do. By flattening the income tax, we increase this disparity.

For example, suppose we were to replace the existing personal income tax with a flat, 3.25 percent tax. Fundamentally, we would make lower- and middle-income Ohioans pay more, so upper-income Ohioans could pay less. A married taxpayer filing jointly with two children and income of \$30,000 would pay \$230 more a year under this flat tax than under the fully implemented 21 percent reduction approved by the General Assembly last year. A single head of household with one child and income of \$40,000 would pay \$214 more. On the other hand, a married taxpayer filing jointly with two children earning \$400,000 would pay \$7,390 less.¹ The vast bulk of Ohioans would pay more, while the amount of revenue generated would decline by hundreds of millions of dollars a year.

Most observers agree that U.S. economic growth is slowing. “Economic growth has moderated from its quite strong pace earlier this year, partly reflecting a gradual cooling of the housing market and the lagged effects of increases in interest rates and energy prices,” the Federal Reserve said on Aug. 8 in deciding not to raise rates.² It is still unclear if we will experience the so-called “soft landing” or not.

There are additional reasons why we should go slow in further reducing the personal income tax. While it’s early to evaluate, Ohio employment has not enjoyed gains over the past year that suggest a positive impact of the tax reform. In July, Ohio had 5,455,900 jobs, according to the survey of employers conducted by the Bureau of Labor Statistics and the Ohio Department of Job & Family Services. This represented an increase of 30,000 jobs from June 2005, when the tax reform was signed. Since that time, jobs have grown by 0.55 percent in Ohio compared to 1.48 percent for the United States. Ohio manufacturing employment has fallen by more than 10,000 jobs during this period, or 1.3 percent, while they were essentially flat – up 17,000 – for the nation as a whole. These

¹ Calculations were made using the Ohio Tax Calculator of the Institute on Taxation and Economic Policy, a nonprofit research group in Washington, D.C. They include personal exemptions, personal and dependent credits, joint filer credits and the low-income credit, both under the current tax and with a flat tax.

² Federal Open Market Committee Press Release,

<http://www.federalreserve.gov/boarddocs/press/monetary/2006/20060808/>, accessed Aug. 15, 2006

numbers, which are the most reliable job numbers available, do not support the idea that Ohio's tax reform is bringing job gains.

That figures, since factors others than state and local taxes are much more important in determining a state's economic growth. As Dr. David Ellis of the Center for Community Solutions testified before a Senate committee last year, "higher state and local taxes are associated with higher levels of per capita gross state product and higher per capita personal income."³ While this does not suggest there is a causal relationship, as he said, it illustrates that tax cuts are not a solution to Ohio's economic problems. Our update of Dr. Ellis's regressions for the fiscal year 2004 continues to show the same thing.

We recommend that the committee look closely at whether the recent tax reforms are producing a stronger Ohio economy before you approve additional tax cuts for upper-income Ohioans and business owners. This includes the proposal to exclude undistributed profits of passthrough entities from the income tax. Besides the lack of evidence that this would bolster the economy, such a measure would further skew the tax system against lower- and middle-income taxpayers. It would create a new enforcement issue: The Department of Taxation would need to audit returns for profit distributions. The committee should carefully evaluate what the revenue loss would be, and whether it behooves Ohio to take this step when other states have not.

State law already provides for tax reductions when state finances will permit it. The Income Tax Reduction Fund automatically reduces income tax rates according to a formula that is based on the amount of surplus revenue in the General Revenue Fund. Rates were reduced between 1996 and 2000, reducing revenues by a cumulative total of \$2.27 billion. The law calls for the rainy day fund to reach 5 percent of the GRF before rates are cut. While we have replenished the rainy day fund, we haven't yet fully done so.

Ohio also continues to have unmet needs. Last year, 25,000 adults with income below the official poverty line were forced off Medicaid because of a tight state budget. We have yet to reconfigure our unconstitutional method of funding primary and secondary education. College is unaffordable to thousands of Ohioans. Cincinnati has launched an effort to make sure every high school graduate can afford to go to college. Shouldn't Ohio consider supporting this state-wide, not just in Cincinnati?

For all these reasons, we recommend that the committee go slow in considering additional tax-cutting measures. However, if you should decide that further tax reductions are in order, an expansion of the homestead exemption is more worthy of consideration than income-tax cuts. We have not yet been able to examine the proposal in House Bill 648 closely, and we will have to study it before we can come to firm conclusions. The committee should examine whether it will affect those who most need the aid, whether this is the best way to expand the homestead exemption, and how it would be paid for. Thank you for the opportunity to testify.

³ Testimony of David A. Ellis, Ph. D. Senior Fellow and Director of Policy, Planning & Programs, Center for Community Solutions on S.B. 1 Before the Ohio Senate Committee on Ways and Means and Economic Development, March 15, 2005.